

## Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name		County
Fiscal Year End	Opinion Date		Date Audit Report Submitted to State	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).


YES  
NO

**Check each applicable box below.** (See instructions for further detail.)

1. ☐ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☐ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☐ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☐ ☐ The local unit has adopted a budget for all required funds.
5. ☐ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☐ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☐ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☐ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☐ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☐ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☐ ☐ The local unit is free of repeated comments from previous years.
12. ☐ ☐ The audit opinion is UNQUALIFIED.
13. ☐ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☐ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☐ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

<b>We have enclosed the following:</b>	Enclosed	Not Required (enter a brief justification)		
Financial Statements	<input type="checkbox"/>			
The letter of Comments and Recommendations	<input type="checkbox"/>			
Other (Describe)	<input type="checkbox"/>			
Certified Public Accountant (Firm Name)		Telephone Number		
Street Address		City	State	Zip
Authorizing CPA Signature 	Printed Name		License Number	

# **City of Chelsea, Michigan**

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## **Financial Report with Supplemental Information June 30, 2007**

# City of Chelsea, Michigan

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# City of Chelsea, Michigan

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## Independent Auditor's Report

To the Members of the City Council  
City of Chelsea, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Chelsea, Michigan (the "City") as of June 30, 2007 and for the year then ended, which collectively comprise the City's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the City of Chelsea, Michigan's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Chelsea, Michigan as of June 30, 2007 and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and the budgetary comparison schedules, as identified in the table of contents, are not required parts of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

To the Members of the City Council  
City of Chelsea, Michigan

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Chelsea, Michigan's basic financial statements. The accompanying other supplemental information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The other supplemental information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Plante & Moran, PLLC*

October 22, 2007

# City of Chelsea, Michigan

## Management's Discussion and Analysis

Our discussion and analysis of the City of Chelsea's (the "City") financial performance provides an overview of the City's financial activities for the year ended June 30, 2007. Please read it in conjunction with the City's financial statements.

### Financial Highlights

As discussed in further detail in this discussion and analysis, the following represents the most significant financial highlights for the year ended June 30, 2007:

- The fund balance in the General Fund is slowly recovering after several years of decline. The fund balance increased from \$253,423 in 2006 to \$321,462 in 2007. The fund balance for the fiscal year ended June 30, 2007 is approximately 9 percent of actual General Fund expenditures. This can be attributed to greater than anticipated state-shared revenue, re-allocation of a portion of wages in general services administration to the various business activity funds, and the retirement and replacement of staff at a lower rate in the Department of Public Works.
- The General Fund had increased, unplanned expenditures in three major areas: (1) an increase in the executive line item due to the severance package for the former city manager and the cost of the interim manager, (2) an increase in the insurance and fringe benefit cost for General Fund employees, and (3) an increase in the police budget to accurately reflect costs, including dispatch.
- The City's support of the Chelsea Area Fire Authority is beginning to stabilize after several years of significant increases. In February 2007, the City Council adopted a change in the Chelsea Area Fire Authority funding formula. A funding formula based on the response hours for the previous five-year period is expected to stabilize the wide variations in the funding apportionment. The City's contribution was \$331,570, which is slightly less than the previous fiscal year.
- State-shared revenue, the City's second largest General Fund revenue source after property taxes, was 13 percent higher than what was budgeted. The City budgeted for \$375,000 but received approximately \$425,000 in state-shared revenue. Due to the uncertainty and ever-changing legislative climate in Michigan, the City will continue to be conservative in its projections of state-shared revenue.
- Cash and cash equivalents in the Electric Fund increased from \$0 in the previous year to \$840,513. Increases in the rates combined with increased gross sales were the driving factor in the recovery of the Electric Fund from previous years. Also, the City implemented a meter testing procedure which determined that certain customers were underbilled in prior years.

# City of Chelsea, Michigan

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## Management's Discussion and Analysis (Continued)

- The Vehicle and Equipment Fund is an Internal Service Fund. This fund includes expenses for wages, benefits, supplies, and repair and maintenance expenses to be charged back to the appropriate funds and budgets based on the work performed on vehicles and equipment in those funds. The new public works superintendent, in conjunction with the director of administrative services, created a recordkeeping and reporting system to accurately track the expenditures in 2006-2007. A deficit elimination plan for the Vehicle and Equipment Fund was filed with the State of Michigan related to the fund's 2005-2006 fiscal year-end status.

### Using this Annual Report

This annual report consists of a series of financial statements. The statement of net assets and the statement of activities provide information about the activities of the City as a whole and present a longer-term view of the City's finances. This longer-term view uses the accrual basis of accounting so that it can measure the cost of providing services during the current year, and whether the taxpayers have funded the full cost of providing government services.

The fund financial statements present a short-term view; they tell us how the taxpayers' resources were spent during the year, as well as how much is available for future spending. Fund financial statements also report the City's operations in more detail than the government-wide financial statements by providing information about the City's most significant funds. The fiduciary fund statements provide financial information about activities for which the City acts solely as a trustee or agent for the benefit of those outside of the government.



# City of Chelsea, Michigan

## Management's Discussion and Analysis (Continued)

### The City as a Whole

The following table shows, in a condensed format, the net assets as of the current date and compared to the prior year:

	Governmental Activities		Business-type Activities		Total	
	2006	2007	2006	2007	2006	2007
<b>Assets</b>						
Current and other assets	\$ 3,556,469	\$ 3,926,900	\$ 2,628,198	\$ 4,549,545	\$ 6,184,667	\$ 8,476,445
Capital assets	39,171,502	38,314,539	27,271,728	27,306,936	66,443,230	65,621,475
Total assets	42,727,971	42,241,439	29,899,926	31,856,481	72,627,897	74,097,920
<b>Liabilities</b>						
Current liabilities	638,381	731,699	1,515,824	1,609,569	2,154,205	2,341,268
Long-term liabilities	2,732,665	2,564,727	8,138,000	7,433,454	10,870,665	9,998,181
Total liabilities	3,371,046	3,296,426	9,653,824	9,043,023	13,024,870	12,339,449
<b>Net Assets</b>						
Invested in capital assets -						
Net of related debt	36,924,834	36,105,394	17,963,330	18,751,650	54,888,164	54,857,044
Restricted	2,151,090	2,871,799	498,398	430,286	2,649,488	3,302,085
Unrestricted	281,001	(32,180)	1,784,374	3,631,522	2,065,375	3,599,342
Total net assets	<u>\$ 39,356,925</u>	<u>\$ 38,945,013</u>	<u>\$ 20,246,102</u>	<u>\$ 22,813,458</u>	<u>\$ 59,603,027</u>	<u>\$ 61,758,471</u>

The City's combined net assets increased approximately 4 percent from a year ago, increasing from \$59.60 million to \$61.76 million. Total net assets related to the City's governmental activities decreased by 1 percent or \$411,912. Net capital assets being depreciated for governmental activities decreased by \$924,626.

Unreserved General Fund fund balance, the part of net assets that can be used to finance day-to-day operations, increased by \$68,039. This represents an increase of 27 percent. The current level of unreserved fund balance for the General Fund is \$321,462, or 9 percent of total General Fund expenditures. This is below a desired target level. Unreserved fund balance as a percentage of total General Fund expenditures for the previous year was 8 percent. Typically, a range of 15 percent to 20 percent is desired.

# City of Chelsea, Michigan

## Management's Discussion and Analysis (Continued)

The following table shows the changes in the net assets during the current year and as compared to the prior year:

	Governmental Activities		Business-type Activities		Total	
	2006	2007	2006	2007	2006	2007
<b>Net Assets - Beginning of year</b>	\$ 40,284,732	\$ 39,356,925	\$ 19,755,493	\$ 20,246,102	\$ 60,040,225	\$ 59,603,027
<b>Revenue</b>						
Program revenue:						
Charges for services	1,012,589	904,509	8,262,821	9,770,757	9,275,410	10,675,266
Operating grants and contributions	340,018	363,418	687,104	1,448,914	1,027,122	1,812,332
Capital grants and contributions	-	447,298	-	-	-	447,298
General revenue:						
Property taxes	2,972,899	3,301,887	176,237	119,167	3,149,136	3,421,054
State-shared revenue	434,942	421,958	-	-	434,942	421,958
Unrestricted investment earnings	155,538	191,002	63,980	77,143	219,518	268,145
Other revenue	-	125,579	-	-	-	125,579
Transfers and other revenue	(388,490)	63,835	388,490	(63,835)	-	-
Total revenue	4,527,496	5,819,486	9,578,632	11,352,146	14,106,128	17,171,632
<b>Program Expenses</b>						
General government	1,210,511	1,388,773	-	-	1,210,511	1,388,773
Public safety	1,187,637	1,511,707	-	-	1,187,637	1,511,707
Public works	2,698,217	3,047,794	-	-	2,698,217	3,047,794
Community and economic development	191,551	199,162	-	-	191,551	199,162
Recreation and culture	57,632	56,195	-	-	57,632	56,195
Interest on long-term debt	109,755	27,767	-	-	109,755	27,767
Water, sewer, and electric	-	-	9,088,023	8,784,790	9,088,023	8,784,790
Total program expenses	5,455,303	6,231,398	9,088,023	8,784,790	14,543,326	15,016,188
<b>Change in Net Assets</b>	(927,807)	(411,912)	490,609	2,567,356	(437,198)	2,155,444
<b>Net Assets - End of year</b>	<u>\$ 39,356,925</u>	<u>\$ 38,945,013</u>	<u>\$ 20,246,102</u>	<u>\$ 22,813,458</u>	<u>\$ 59,603,027</u>	<u>\$ 61,758,471</u>

### Governmental Activities

The City's total revenues for governmental activities were \$5,819,486, an increase of 28.54 percent from the previous year.

Expenses were \$6,231,398 during the year, which is an increase of 14.23 percent from the previous year.

City departments in the General Fund exceeded the original budget overall by \$45,534 or 1.24 percent.

# City of Chelsea, Michigan

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## Management's Discussion and Analysis (Continued)

Major expenditure overruns include police wages, severance package for the former city manager, and salary-based fringe benefit payments such as Social Security, Medicare, and workers' compensation. These overruns were offset by postponing filling certain positions, postponing certain capital outlay projects, and smaller reductions in individual line items.

### **Business-type Activities**

The City's business-type activities consist of the Water, Sewer, and Electric Funds. The City provides water to residents from five groundwater wells and processes the water through a water treatment plant that provides iron removal and reverse osmosis softening. Sewage treatment is provided through a City-owned and operated sewage treatment plant. The City provides electrical service to its residents and businesses with power purchase agreements with the Michigan Public Power Agency and Constellation Energy. The City owns all of the substations and local electric transmission lines and, through the Michigan Public Power Agency, has part ownership of a regional transmission line.

In June 2005, the City contracted with Utility Financial Solutions to conduct a comprehensive cost-of-service study for its water, sewer, and electric utilities. The consultant recommended rate increases for all three utilities over the next five years. The first year recommended rate increases were not implemented until the March 2006 billing cycle. Following the schedule recommended by Utility Financial Solutions, the City also increased rates in March 2007 for water, sewer, and electric utilities.

The Electric Fund had operating revenues of \$7,558,436, an increase of \$1,370,743 over the budgeted amount of \$6,187,693. Expenses were projected to be \$6,187,693. Actual expenses were \$6,211,907. Increases in the rates combined with increased gross sales were the driving factor in the recovery of the Electric Fund from previous years. Also, the City implemented a meter testing procedure which determined that certain customers were underbilled in prior years. The cash balance increased from \$0 in the previous year to \$840,513.

The Wastewater (Sewer) Fund had operating revenues of \$813,516. This was an increase from the previous year as a result of the cost-of-service study which recommended a 9 percent increase in sewer rates. The Sewer Fund had expenses of \$1,225,851. This was a decrease of approximately \$54,000. The cash balance of the Wastewater Fund is \$908,434.

The Water Fund recorded operating revenues of \$1,398,805. This was an increase from the previous year which was also the result of an increase in water rates. The Water Fund expenses were \$1,061,481, which were significantly less than projected. The primary variance was the elimination of services by a vendor (G.E.) equal to \$308,000. The Water Fund cash balance is \$704,703.

# **City of Chelsea, Michigan**

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## **Management's Discussion and Analysis (Continued)**

### **The City's Funds**

Our analysis of the City's major funds follows the government-wide financial statements. The fund financial statements provide detail information about the most significant funds, not the City as a whole. The City Council creates funds to help manage money for specific purposes as well as to show accountability for certain activities, such as special property tax millages. The City's major funds for the current year include the General Fund, the Coliseum Drive Capital Project Fund, and the Major Roads Fund.

An analysis of the General Fund was presented earlier in this discussion and analysis.

### **Capital Asset and Debt Administration**

As of June 30, 2007, the City had approximately \$64.7 million (net of depreciation) invested in a broad range of capital assets including roads, buildings, equipment, and water, sewer, and electric lines.

On November 30, 2004, Moody's Investor Service affirmed its A3 rating on the City's outstanding \$630,000 general obligation unlimited tax debt. The outstanding general obligation unlimited tax debt as of June 30, 2007 is \$170,000.

More detailed information concerning capital assets and long-term debt can be found in Notes 4 and 6, respectively, in the notes to the financial statements.

### **Economic Factors and Next Year's Budgets and Rates**

The City's 2006-2007 fiscal year budget increased 9 percent in order to meet rising healthcare and retirement costs, as well as slowly build back the General Fund reserves. The City completed an analysis for its defined benefit retirement plan in 2006. The results show the City was significantly underfunded. As a result, the City implemented a 10-year "catch-up" plan, and subsequently will be required to raise the property tax rate to finance the shortfall.

The City Council will be requested to increase utility rates in the coming fiscal year. The overall rate increases are expected to be equivalent or less than those implemented in March 2007. The City is proceeding to expand the wastewater treatment plant and make other improvements in the wastewater system using grants and loans under the Michigan State Revolving Loan Fund program. Construction on the expansion is expected to begin in 2008. The expansion of the Waste Water Treatment Plant in 2008 will require the rate structure to accommodate the new debt service, which will start in fiscal year 2008-2009.

The City's commercial and industrial areas continue to be viable. The City's downtown and commercial area on Main Street south of Old US-12 continues to have low vacancy rates. The Federal Screw Works building on Main Street was recently sold and, once redeveloped, will add to the vitality of the downtown.

# **City of Chelsea, Michigan**

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## **Management's Discussion and Analysis (Continued)**

Renovation of the Clocktower Commons building in the Clocktower complex is substantially complete and the developer is working on attracting business to those spaces. A couple of large spaces in the Clocktower complex have been filled with new or expanded businesses. The Rockwell Building on this site is currently under renovation and is ahead of schedule.

The City is exploring options for a new municipal office facility, police station, and waste water treatment plant. These projects may require the issuance of bonds.

### **Contacting the City's Management**

This financial report is intended to provide our citizens, taxpayers, customers, and investors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional information, we welcome you to contact the City's office.

# City of Chelsea, Michigan

## Statement of Net Assets June 30, 2007

	Primary Government			Component
	Governmental	Business-type		Units
	Activities	Activities	Total	
<b>Assets</b>				
Cash and investments (Note 2)	\$ 2,959,767	\$ 2,453,650	\$ 5,413,417	\$ 294,030
Receivables:				
Taxes	83,205	-	83,205	-
Customers	51,437	1,554,353	1,605,790	-
Special assessments (Note 3)	589,770	-	589,770	-
Other	10,780	-	10,780	1,656
Due from other governmental units	201,987	19,445	221,432	8,857
Due from primary government	-	-	-	33,458
Inventories	-	518,697	518,697	-
Prepaid costs and other assets	-	3,400	3,400	-
Restricted assets (Note 7)	-	430,286	430,286	-
Investment in joint ventures (Note 10)	459,643	-	459,643	-
Capital assets - Net (Note 4):				
Nondepreciated	4,539,575	2,792,539	7,332,114	586,737
Depreciated	33,315,321	24,084,111	57,399,432	1,698,293
Pension asset (Note 9)	29,954	-	29,954	-
<b>Total assets</b>	<b>42,241,439</b>	<b>31,856,481</b>	<b>74,097,920</b>	<b>2,623,031</b>
<b>Liabilities</b>				
Accounts payable	171,783	616,393	788,176	16,195
Accrued and other liabilities	178,324	196,176	374,500	52
Due to component units (Note 5)	33,458	-	33,458	-
Noncurrent liabilities (Note 6):				
Due within one year	348,134	797,000	1,145,134	135,000
Due in more than one year	2,564,727	7,433,454	9,998,181	295,000
<b>Total liabilities</b>	<b>3,296,426</b>	<b>9,043,023</b>	<b>12,339,449</b>	<b>446,247</b>
<b>Net Assets</b>				
Invested in capital assets - Net of related debt	36,105,394	18,751,650	54,857,044	1,855,030
Restricted:				
Streets and highways	1,697,654	-	1,697,654	-
Law enforcement	140,929	-	140,929	-
Solid waste activities	270,439	-	270,439	-
Storm water utility	134,408	-	134,408	-
Debt service	-	430,286	430,286	-
Capital projects	628,369	-	628,369	-
Unrestricted	(32,180)	3,631,522	3,599,342	321,754
<b>Total net assets</b>	<b>\$ 38,945,013</b>	<b>\$ 22,813,458</b>	<b>\$ 61,758,471</b>	<b>\$ 2,176,784</b>

# City of Chelsea, Michigan

		Program Revenues		
		Charges for	Operating	Capital Grants
	Expenses	Services	Grants and Contributions	and Contributions
<b>Functions/Programs</b>				
Primary government:				
Governmental activities:				
General government	\$ 1,388,773	\$ 421,584	\$ 6,101	\$ -
Public safety	1,511,707	-	64,763	-
Public works	3,047,794	463,378	292,554	447,298
Community and economic development	199,162	19,547	-	-
Recreation and culture	56,195	-	-	-
Interest on long-term debt	27,767	-	-	-
Total governmental activities	6,231,398	904,509	363,418	447,298
Business-type activities:				
Water	1,301,441	1,398,805	-	320,501
Sewer	1,262,361	813,516	-	1,127,693
Electric	6,220,988	7,558,436	-	720
Total business-type activities	8,784,790	9,770,757	-	1,448,914
Total primary government	<u>\$ 15,016,188</u>	<u>\$ 10,675,266</u>	<u>\$ 363,418</u>	<u>\$ 1,896,212</u>
Component units:				
Downtown Development Authority	\$ 187,858	-	-	-
Economic Development Corporation	-	-	-	-
Total component units	<u>\$ 187,858</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

## General revenues:

Property taxes

State-shared revenues

Unrestricted investment earnings

Other revenues

Transfers

Total general revenues and transfers

## Change in Net Assets

**Net Assets** - Beginning of year

**Net Assets** - End of year

**Statement of Activities**  
**Year Ended June 30, 2007**

Net (Expense) Revenue and Changes in Net Assets			
Primary Government			Component Units
Governmental Activities	Business-type Activities	Total	
\$ (961,088)	-	\$ (961,088)	-
(1,446,944)	-	(1,446,944)	-
(1,844,564)	-	(1,844,564)	-
(179,615)	-	(179,615)	-
(56,195)	-	(56,195)	-
(27,767)	-	(27,767)	-
(4,516,173)	-	(4,516,173)	-
-	417,865	417,865	-
-	678,848	678,848	-
-	1,338,168	1,338,168	-
-	2,434,881	2,434,881	-
(4,516,173)	2,434,881	(2,081,292)	-
-	-	-	(187,858)
-	-	-	-
-	-	-	(187,858)
3,301,887	119,167	3,421,054	295,208
421,958	-	421,958	-
191,002	77,143	268,145	3,220
125,579	-	125,579	-
63,835	(63,835)	-	-
4,104,261	132,475	4,236,736	298,428
(411,912)	2,567,356	2,155,444	110,570
39,356,925	20,246,102	59,603,027	2,066,214
<b>\$ 38,945,013</b>	<b>\$ 22,813,458</b>	<b>\$ 61,758,471</b>	<b>\$ 2,176,784</b>



# City of Chelsea, Michigan

## Governmental Funds Balance Sheet June 30, 2007

	Major Funds				Total Governmental Funds
	General	Coliseum Drive	Major Roads	Other Nonmajor Funds	
<b>Assets</b>					
Cash and investments (Note 2)	\$ 357,054	\$ 38,599	\$ 689,013	\$ 1,875,101	\$ 2,959,767
Receivables:					
Taxes	72,469	-	-	10,736	83,205
Customers	-	-	-	51,437	51,437
Special assessments (Note 3)	-	589,770	-	-	589,770
Other	10,740	-	-	-	10,740
Due from other funds (Note 5)	23,649	-	-	-	23,649
Due from other governmental units	78,793	-	37,990	10,371	127,154
	<u>\$ 542,705</u>	<u>\$ 628,369</u>	<u>\$ 727,003</u>	<u>\$ 1,947,645</u>	<u>\$ 3,845,722</u>
Total assets					
<b>Liabilities and Fund Balances</b>					
<b>Liabilities</b>					
Accounts payable	\$ 76,231	\$ -	\$ 37,638	\$ 47,966	\$ 161,835
Accrued and other liabilities	134,396	-	-	23,685	158,081
Due to other funds (Note 5)	-	-	8,010	22,433	30,443
Due to component units	10,616	-	-	22,842	33,458
Deferred revenue (Note 3)	-	589,770	-	-	589,770
	<u>221,243</u>	<u>589,770</u>	<u>45,648</u>	<u>116,926</u>	<u>973,587</u>
Total liabilities					
<b>Fund Balances</b>					
Reserved for:					
Law enforcement	-	-	-	140,929	140,929
Solid waste maintenance	-	-	-	270,439	270,439
Storm water utility	-	-	-	134,408	134,408
Unreserved, reported in:					
General Fund	321,462	-	-	-	321,462
Special Revenue Funds	-	-	681,355	1,016,299	1,697,654
Capital Projects Funds	-	38,599	-	268,644	307,243
	<u>321,462</u>	<u>38,599</u>	<u>681,355</u>	<u>1,830,719</u>	<u>2,872,135</u>
Total fund balances					
Total liabilities and fund balances	<u>\$ 542,705</u>	<u>\$ 628,369</u>	<u>\$ 727,003</u>	<u>\$ 1,947,645</u>	<u>\$ 3,845,722</u>

# City of Chelsea, Michigan

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## Governmental Funds Reconciliation of Fund Balances of Governmental Funds to the Statement of Net Assets Year Ended June 30, 2007

<b>Total Fund Balances of Governmental Funds</b>	<b>\$ 2,872,135</b>
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Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and are not reported in the funds	37,365,253
Revenue sharing due from the State not received within 60 days of year end is not available currently and is not recorded in the funds	74,833
Special assessment receivables are expected to be collected over several years and are not available to pay for current year expenditures	589,770
Long-term liabilities are not due and payable in the current period and are not reported in the funds	(2,660,802)
Investments in joint ventures are not financial resources and are not reported in the funds	459,643
Net pension asset in governmental activities is not reported in the funds	29,954
Interest amounts on long-term liabilities are not payable until due in the funds	(14,005)
Internal Service Funds are included as part of governmental activities	<u>228,232</u>

<b>Net Assets of Governmental Activities</b>	<b><u>\$ 38,945,013</u></b>
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# City of Chelsea, Michigan

## Governmental Funds Statement of Revenue, Expenditures, and Changes in Fund Balances Year Ended June 30, 2007

	Major Funds			Other	Total
	General	Coliseum Drive	Major Roads	Nonmajor Funds	Governmental Funds
<b>Revenue</b>					
Property taxes	\$ 2,858,113	\$ -	\$ -	\$ 443,774	\$ 3,301,887
Special assessments	-	45,367	-	-	45,367
Federal sources	3,327	-	-	-	3,327
State sources	429,414	-	229,397	63,573	722,384
Local sources	-	-	-	62,778	62,778
License and permits	191,647	-	-	-	191,647
Charges for services	9,643	-	-	463,378	473,021
Fines and forfeitures	15,557	-	-	-	15,557
Interest and other	266,944	40,204	40,021	65,376	412,545
Total revenue	3,774,645	85,571	269,418	1,098,879	5,228,513
<b>Expenditures</b>					
General government	960,890	-	5,817	253,126	1,219,833
Public safety	1,140,869	-	-	-	1,140,869
Public works	560,019	-	400,422	559,650	1,520,091
Parks and recreation	55,595	-	-	-	55,595
Planning and zoning	199,162	-	-	-	199,162
Employee benefits and insurance	759,759	-	-	-	759,759
Debt service	-	84,662	-	94,509	179,171
Total expenditures	3,676,294	84,662	406,239	907,285	5,074,480
<b>Excess of Revenue Over (Under)</b>					
<b>Expenditures</b>	98,351	909	(136,821)	191,594	154,033
<b>Other Financing Sources (Uses)</b>					
Transfers in (Note 5)	15,000	-	-	166,800	181,800
Transfers out (Note 5)	(45,312)	-	-	(90,000)	(135,312)
Total other financing sources (uses)	(30,312)	-	-	76,800	46,488
<b>Net Change in Fund Balances</b>	68,039	909	(136,821)	268,394	200,521
<b>Fund Balances - Beginning of year</b>	253,423	37,690	818,176	1,562,325	2,671,614
<b>Fund Balances - End of year</b>	<u>\$ 321,462</u>	<u>\$ 38,599</u>	<u>\$ 681,355</u>	<u>\$ 1,830,719</u>	<u>\$ 2,872,135</u>

# City of Chelsea, Michigan

## **Governmental Funds** **Reconciliation of the Statement of Revenue, Expenditures,** **and Changes in Fund Balances of Governmental Funds** **to the Statement of Activities** **Year Ended June 30, 2007**

<b>Net Change in Fund Balances - Total Governmental Funds</b>	<b>\$ 200,521</b>
Amounts reported for governmental activities in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures; in the statement of activities, these costs are allocated over their estimated useful lives as depreciation	(1,397,363)
Revenue associated with contributed assets is recorded in the statement of activities; it is not reported in the funds	447,298
Revenue sharing is recorded in the statement of activities when the revenue is earned; it is not reported in the funds until collected or collectible within 60 days of year end	(7,456)
Special assessment revenues are recorded in the statement of activities when the assessment is set; they are not reported in the funds until collected or collectible within 60 days of year end	(45,366)
Repayment of bond principal is an expenditure in the governmental funds, but not in the statement of activities (where it reduces long-term debt) - Net of proceeds	99,964
Change in accumulated employee sick and vacation pay is recorded when earned in the statement of activities	29,758
Payment of landfill postclosure costs is an expenditure in the governmental funds, but not in the statement of activities (where it reduces the long-term liability)	60,000
Change in the equity interest in the Chelsea Area Construction Agency is not reported in the governmental funds	(4,101)
Change in the equity interest in the Chelsea Area Fire Authority is not reported in the governmental funds	71,764
Change in net pension asset is recorded when incurred in the statement of activities	29,954
Accrued interest payable is recorded when due in governmental funds	1,476
Internal Service Funds are also included as governmental activities	<u>101,639</u>
<b>Change in Net Assets of Governmental Activities</b>	<b><u>\$ (411,912)</u></b>

# City of Chelsea, Michigan

## Proprietary Funds Statement of Net Assets June 30, 2007

	Enterprise Funds - Major Funds				Internal Service Fund
	Water	Sewer	Electric	Total Major Funds	
<b>Assets</b>					
Current assets:					
Cash and cash equivalents (Note 2)	\$ 704,703	\$ 908,434	\$ 840,513	\$ 2,453,650	\$ -
Receivables:					
Customers	228,242	124,292	1,201,819	1,554,353	-
Other	-	-	-	-	40
Due from other funds (Note 5)	-	-	-	-	7,601
Due from other governmental units	-	-	19,445	19,445	-
Inventories	67,841	-	450,856	518,697	-
Prepaid costs and other assets	-	3,400	-	3,400	-
Total current assets	1,000,786	1,036,126	2,512,633	4,549,545	7,641
Long-term assets:					
Restricted assets (Note 7)	220,390	209,896	-	430,286	-
Capital assets (Note 4)	11,127,370	12,690,616	3,058,664	26,876,650	489,643
Total assets	12,348,546	13,936,638	5,571,297	31,856,481	497,284
<b>Liabilities</b>					
Current liabilities:					
Current portion of long-term liabilities	445,965	299,568	51,467	797,000	53,133
Accounts payable	42,512	52,608	521,273	616,393	9,948
Accrued and other liabilities	89,122	13,815	93,239	196,176	6,238
Due to other funds (Note 5)	-	-	-	-	807
Total current liabilities	577,599	365,991	665,979	1,609,569	70,126
Long-term liabilities - Net of current portion	7,325,000	108,454	-	7,433,454	198,926
Total liabilities	7,902,599	474,445	665,979	9,043,023	269,052
<b>Net Assets</b>					
Investment in capital assets - Net of related debt	3,367,370	12,325,616	3,058,664	18,751,650	237,584
Restricted for bond reserves/debt service	220,390	209,896	-	430,286	-
Unrestricted	858,187	926,681	1,846,654	3,631,522	(9,352)
Total net assets	<u>\$ 4,445,947</u>	<u>\$ 13,462,193</u>	<u>\$ 4,905,318</u>	<u>\$ 22,813,458</u>	<u>\$ 228,232</u>

# City of Chelsea, Michigan

## Proprietary Funds Statement of Revenue, Expenses, and Changes in Net Assets Year Ended June 30, 2007

	Enterprise Funds - Major Funds				Internal Service Fund
	Water	Sewer	Electric	Total Major Funds	
<b>Operating Revenue</b>					
Charges for services	\$ 1,377,142	\$ 809,841	\$ 7,521,451	\$ 9,708,434	\$ 389,220
Other	21,663	3,675	36,985	62,323	7,083
Total operating revenue	1,398,805	813,516	7,558,436	9,770,757	396,303
<b>Operating Expenses</b>					
Cost of electricity	-	-	4,654,709	4,654,709	-
Operation and maintenance	217,856	274,305	57,052	549,213	111,735
General and administrative	392,443	469,152	826,344	1,687,939	126,853
Professional/Contractor services	70,939	83,970	87,992	242,901	-
Payment in lieu of taxes	-	-	331,500	331,500	-
Depreciation and amortization	356,583	377,050	222,606	956,239	64,838
Other	23,660	21,374	31,704	76,738	532
Total operating expenses	1,061,481	1,225,851	6,211,907	8,499,239	303,958
<b>Operating Income (Loss)</b>	337,324	(412,335)	1,346,529	1,271,518	92,345
<b>Nonoperating Revenue (Expense)</b>					
Property taxes	-	119,167	-	119,167	-
State grants and distributions	-	852,227	-	852,227	-
Interest income	23,485	49,537	4,121	77,143	-
Interest expense	(218,225)	(29,567)	(9,081)	(256,873)	(8,053)
Loss on disposal of capital assets	(21,735)	(6,943)	-	(28,678)	-
Total nonoperating revenue (expense)	(216,475)	984,421	(4,960)	762,986	(8,053)
<b>Income - Before transfers and capital contributions</b>	120,849	572,086	1,341,569	2,034,504	84,292
<b>Other Financing Uses - Transfers out (Note 5)</b>	(16,128)	(47,707)	-	(63,835)	-
<b>Capital Contributions</b>					
Customer connection fees	320,501	275,466	-	596,687	-
Contributed capital	-	-	720	-	17,347
Total capital contributions	320,501	275,466	720	596,687	17,347
<b>Change in Net Assets</b>	425,222	799,845	1,342,289	2,567,356	101,639
<b>Net Assets - Beginning of year</b>	4,020,725	12,662,348	3,563,029	20,246,102	126,593
<b>Net Assets - End of year</b>	<u>\$ 4,445,947</u>	<u>\$ 13,462,193</u>	<u>\$ 4,905,318</u>	<u>\$ 22,813,458</u>	<u>\$ 228,232</u>

# City of Chelsea, Michigan

## Proprietary Funds Statement of Cash Flows Year Ended June 30, 2007

	Enterprise Funds - Major Funds			Internal Service Fund
	Water	Sewer	Electric	
<b>Cash Flows from Operating Activities</b>				
Receipts from customers	\$ 1,358,295	\$ 786,094	\$ 7,232,377	\$ 396,303
Payments to suppliers	(477,888)	(387,600)	(5,128,185)	(143,255)
Payments to employees	(252,286)	(342,014)	(514,742)	(92,790)
Internal activity - Payments to other funds in lieu of taxes	-	-	(331,500)	-
Net cash provided by operating activities	628,121	56,480	1,257,950	160,258
<b>Cash Flows from Noncapital Financing Activities</b>				
Internal activity - Payments to other funds	-	253,165	(412,477)	(74,053)
Transfers to other funds	(16,128)	(47,707)	-	-
Net cash provided by (used in) noncapital financing activities	(16,128)	205,458	(412,477)	(74,053)
<b>Cash Flows from Capital and Related Financing Activities</b>				
Collection of customer assessments (principal and interest)	-	16,225	-	-
Collection of property taxes	-	119,167	-	-
Transfers to other funds	-	-	41,157	-
Contributed capital	-	-	720	-
Connection fees	320,501	275,466	-	-
Capital grant	-	852,227	-	-
Purchase of capital assets	(60,541)	(1,134,476)	(41,877)	(72,930)
Proceeds from issuance of long-term debt	-	-	-	48,873
Principal and interest paid on capital debt	(638,563)	(289,567)	(9,081)	(62,148)
Net cash used in capital and related financing activities	(378,603)	(160,958)	(9,081)	(86,205)
<b>Cash Flows from Investing Activities</b> - Interest received on investments	23,485	49,034	4,121	-
<b>Net Increase in Cash and Cash Equivalents</b>	256,875	150,014	840,513	-
<b>Cash and Cash Equivalents</b> - Beginning of year	668,218	880,481	-	-
<b>Cash and Cash Equivalents</b> - End of year	<u>\$ 925,093</u>	<u>\$ 1,030,495</u>	<u>\$ 840,513</u>	<u>\$ -</u>
<b>Balance Sheet Classification of Cash and Cash Equivalents and Restricted Cash</b>				
Cash and investments	\$ 704,703	\$ 908,434	\$ 840,513	\$ -
Restricted investments (Note 7)	220,390	122,061	-	-
Total cash and cash equivalents	<u>\$ 925,093</u>	<u>\$ 1,030,495</u>	<u>\$ 840,513</u>	<u>\$ -</u>

# City of Chelsea, Michigan

## Proprietary Funds Statement of Cash Flows (Continued) Year Ended June 30, 2007

	Enterprise Funds - Major Funds			Internal Service Fund
	Water	Sewer	Electric	
<b>Reconciliation of Operating Income (Loss) to Net Cash from Operating Activities</b>				
Operating income (loss)	\$ 337,324	\$ (412,335)	\$ 1,346,529	\$ 92,345
Adjustments to reconcile operating income (loss) to net cash from operating activities:				
Depreciation and amortization	356,583	377,050	222,606	64,838
Changes in assets and liabilities:				
Customer receivables	(40,510)	(27,422)	(303,068)	-
Prepaid and other assets	-	566	-	434
Due from other governmental units	-	-	(19,445)	-
Inventories	7,132	-	(79,496)	-
Accounts payable	(39,430)	117,257	88,085	4,152
Accrued and other liabilities	7,022	1,364	2,739	(1,511)
Net cash provided by operating activities	<u>\$ 628,121</u>	<u>\$ 56,480</u>	<u>\$ 1,257,950</u>	<u>\$ 160,258</u>

**Noncash Investing, Capital, and Financing Activities** - During the year ended June 30, 2007, there were no noncash activities.



# City of Chelsea, Michigan

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## **Fiduciary Fund - Agency Fund Statement of Assets and Liabilities June 30, 2007**

	<u>Tax Collections</u>
<b>Assets</b>	
Cash and cash equivalents (Note 2)	\$ 65
Due from other governmental units	<u>8,851</u>
Total assets	<u><b>\$ 8,916</b></u>
<b>Liabilities - Due to other governmental units</b>	<u><b>\$ 8,916</b></u>

# City of Chelsea, Michigan

## Component Units Statement of Net Assets June 30, 2007

	Downtown Development Authority	Economic Development Corporation	Total
<b>Assets</b>			
Cash and investments (Note 2)	\$ 293,131	\$ 899	\$ 294,030
Receivables	1,656	-	1,656
Due from other governmental units	8857	-	8,857
Due from primary government	33,458	-	33,458
Capital assets (Note 4)	2,285,030	-	2,285,030
Total assets	2,622,132	899	2,623,031
<b>Liabilities</b>			
Accounts payable	16,195	-	16,195
Accrued and other liabilities	52	-	52
Noncurrent liabilities (Note 6):			
Due within one year	135,000	-	135,000
Due in more than one year	295,000	-	295,000
Total liabilities	446,247	-	446,247
<b>Net Assets</b>			
Investment in capital assets - Net of related debt	1,855,030	-	1,855,030
Unrestricted	320,855	899	321,754
Total net assets	<u>\$ 2,175,885</u>	<u>\$ 899</u>	<u>\$ 2,176,784</u>

# City of Chelsea, Michigan

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	Expenses	Program Revenues
Downtown Development Authority - Community and economic development	\$ 187,858	\$ -
Economic Development Corporation - Community and economic development	-	-
Total governmental activities	<u><u>\$ 187,858</u></u>	<u><u>\$ -</u></u>
General revenues:		
Property taxes		
Interest and other		
Total general revenues		
<b>Change in Net Assets</b>		
<b>Net Assets - Beginning of year</b>		
<b>Net Assets - End of year</b>		

**Component Units  
Statement of Activities  
Year Ended June 30, 2007**

Net (Expense) Revenue and Changes in Net Assets		
Downtown Development Authority	Economic Development Corporation	Total
\$ (187,858)	\$ -	\$ (187,858)
-	-	-
(187,858)	-	(187,858)
295,208	-	295,208
3,217	3	3,220
298,425	3	298,428
110,567	3	110,570
2,065,318	896	2,066,214
<b>\$ 2,175,885</b>	<b>\$ 899</b>	<b>\$ 2,176,784</b>

### **Note I - Summary of Significant Accounting Policies**

The accounting policies of the City of Chelsea, Michigan (the "City") conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the City:

#### **Reporting Entity**

The City is governed by an elected seven-member council. The accompanying financial statements present the City and its component units, entities for which the City is considered to be financially accountable. Although blended component units are legally separate entities, in substance, they are part of the City's operations. Each discretely presented component unit is reported in a separate column in the government-wide financial statements to emphasize that it is legally separate from the City (see discussion below for description).

#### **Blended Component Units**

The City of Chelsea Building Authority is governed by a board that is appointed by the City Council. Although it is legally separate from the City, it is reported as if it were part of the primary government because its sole purpose is to finance and construct City capital assets.

#### **Discretely Presented Component Units**

The following component units are reported within the component units column in the financial statements. They are reported in a separate column in the government-wide financial statements to emphasize that they are legally separate from the City.

- a. The Downtown Development Authority (the "Authority") was created to correct and prevent deterioration in the downtown district, encourage historical preservation, and to promote economic growth within the downtown district. The Authority's governing body, which consists of 13 individuals, is selected by the City president. In addition, the Authority's budget is subject to approval by the City Council. No separately issued financial statements have been prepared for the Authority.

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

- b. The Economic Development Corporation (the "Corporation") was created to provide means and methods for the encouragement and assistance of industrial and commercial enterprises in relocating, purchasing, constructing, improving, or expanding within the City so as to provide needed services and facilities of such enterprises to the residents of the City. The Corporation's governing body, which consists of nine individuals, is selected by the City president. No separately issued financial statements have been prepared for the Corporation.

#### **Government-wide and Fund Financial Statements**

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenue.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual Enterprise Funds are reported as separate columns in the fund financial statements.

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current year or soon enough thereafter to pay liabilities of the current year. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

The City reports the following major governmental funds:

**General Fund** - The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

**Coliseum Drive Fund** - The Coliseum Drive Fund is a Capital Project Fund that was created to account for the construction of the Coliseum Drive, funded through a special assessment.

**Major Roads Fund** - The Major Roads Fund is used to account for the resources of state gas and weight tax revenues that are restricted for use on major roads.

The City reports the following major proprietary funds:

**Water Fund** - The Water Fund accounts for the activities of the water distribution system, financed primarily by a user charge for the provision of those services.

**Sewer Fund** - The Sewer Fund accounts for the activities of the sewer collection system, financed primarily by a user charge for the provision of those services.

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

**Electric Fund** - The Electric Fund accounts for the activities of the electric distribution system, financed primarily by a user charge for the provision of those services.

Additionally, the City reports the following fund types:

**Special Revenue Funds** - Special Revenue Funds are used to account for the proceeds of earmarked revenue or financing activities requiring separate accounting because of legal or regulatory provisions.

**Capital Project Fund** - The Capital Project Fund is used to account for the construction of a new City office building. Revenues consist of interest income on investments and transfers from other funds for debt service.

**Internal Service Fund** - The Internal Service Fund is used to account for major machinery and equipment purchases and maintenance provided to other departments of the City on a cost reimbursement basis.

**Agency Fund** - The Agency Fund accounts for assets held by the City in a trustee capacity. Agency Funds are custodial in nature (assets equal liabilities) and do not involve the measurement of results of operations.

Private sector standards of accounting issued prior to December 1, 1989 are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. The City has elected not to follow private sector standards issued after November 30, 1989 for its business-type activities.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the City's water, sewer, and electric functions and various other functions of the City. Eliminations of these charges would distort the direct costs and program revenues reported for the various functions concerned.



### **Note 1 - Summary of Significant Accounting Policies (Continued)**

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the City's proprietary funds relates to charges to customers for sales and services. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

When an expense has been incurred for purposes for which both restricted and unrestricted resources exist, it is the City's policy to first apply restricted resources.

#### **Property Tax Revenue**

All trade and property tax receivables are shown as net of allowance for uncollectible amounts. Property taxes are levied on each July 1 on the taxable valuation of property as of the preceding December 31. Taxes are considered delinquent on March 1 of the following year, at which time penalties and interest are assessed.

The 2006 taxable valuation of the City totaled approximately \$230,996,000, on which ad valorem taxes levied consisted of 11.2494 mills for the City's general operating purposes, 1.5246 mills for street improvements, 0.4369 mills for solid waste operations, and 0.5000 mills for sewer-related debt service. The ad valorem taxes levied raised approximately \$2,530,000 for operations (which are net of various refunds and TIFA transfers paid during the year ended June 30, 2007), approximately \$345,000 for street improvements, approximately \$98,000 for solid waste operations, and approximately \$118,000 for sewer-related debt service. In addition, the General Fund received various payments in lieu of taxes during the year approximating \$332,000. These amounts are recognized in the respective General Fund, Special Revenue Fund, and Debt Service Fund financial statements as tax revenue.

#### **Assets, Liabilities, and Net Assets or Equity**

**Bank Deposits and Investments** - Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

### Note 1 - Summary of Significant Accounting Policies (Continued)

**Receivables and Payables** - In general, outstanding balances between funds are reported as "due to/from other funds." Activity between funds that is representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as "advances to/from other funds." Any residual balances outstanding between the governmental activities and the business-type activities are reported in the government-wide financial statements as "internal balances."

**Inventories** - Inventories are valued at cost, on a first-in, first-out basis.

**Restricted Assets** - The restricted assets in the Water and Sewer Funds consist of cash and cash equivalents, investments, and property tax and assessments receivable restricted to provide debt service principal and interest.

**Capital Assets** - Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the City as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

Buildings, equipment, and vehicles are depreciated using the straight-line method over the following useful lives:

Governmental activities:

Roads and sidewalks	11 to 50 years
Buildings and improvements	50 years
Vehicles	3 to 15 years
Equipment	5 to 20 years

Business-type activities:

Land improvements	20 years
Infrastructure	10 to 50 years
Vehicles	5 to 15 years
Equipment	5 to 10 years
Office equipment	5 to 10 years
Building	20 to 50 years
Water tower	10 to 50 years
Special assessment district	50 years

### **Note I - Summary of Significant Accounting Policies (Continued)**

**Compensated Absences (Vacation and Sick Leave)** - It is the City's policy to permit employees to accumulate earned but unused sick and vacation pay benefits. All vacation and sick pay is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only for employee terminations as of year end.

**Long-term Obligations** - In the government-wide financial statements and the proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund-type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt. In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current year. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts are reported as other financing uses. Issuance costs are reported as debt service expenditures.

**Fund Equity** - In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

**Comparative Data** - Comparative data is not included in the City's financial statements.

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

### **Note 2 - Deposits and Investments**

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The City has designated five banks for the deposit of its funds. The investment policy adopted by the council in accordance with Public Act 196 of 1997 has authorized investment in bonds and securities of the United States government and bank accounts and CDs, commercial paper rated within the two highest classifications, with matures more than 270 days after the date of purchase, repurchase agreements, bankers' acceptances of U.S. banks, mutual funds, and investment pools. The City's deposits and investment policies are in accordance with statutory authority.

The City's cash and investments are subject to several types of risk, which are examined in more detail below:

**Custodial Credit Risk of Bank Deposits** - Custodial credit risk is the risk that in the event of a bank failure, the City's deposits may not be returned to it. The City does not have a deposit policy for custodial credit risk. At year end, the City had \$5,279,098 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The City believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the City evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

### Note 2 - Deposits and Investments (Continued)

**Credit Risk** - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The City has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Rating</u>
Interlocal Agreement Fund	\$ 220,390	Not rated

### Note 3 - Receivables/Deferred Revenue

On the fund-based financial statements, governmental funds report deferred revenue in connection with receivables for revenue that is not considered to be available to liquidate liabilities of the current year. Governmental funds also defer revenue recognition in connection with resources that have been received but not yet earned. At the end of the current fiscal year, \$589,770 of the deferred revenue balance was comprised of special assessments, which are unavailable in the governmental funds.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 4 - Capital Assets

Capital asset activity of the City's governmental and business-type activities was as follows:

	Balance July 1, 2006	Additions	Disposals	Balance June 30, 2007
<b>Governmental Activities</b>				
Capital assets not being depreciated -				
Land	\$ 4,539,575	\$ -	\$ -	\$ 4,539,575
Capital assets being depreciated:				
Roads and sidewalks	49,809,028	447,298	27,811	50,228,515
Buildings and improvements	746,676	51,680	-	798,356
Vehicles	624,181	75,024	138,046	561,160
Equipment	<u>1,646,075</u>	<u>121,704</u>	<u>114,441</u>	<u>1,653,339</u>
Subtotal	52,825,960	695,706	280,297	53,241,369
Accumulated depreciation:				
Roads and sidewalks	16,785,272	1,437,491	740	18,222,023
Buildings and improvements	314,073	12,707	-	326,780
Vehicles	402,078	40,699	153,223	289,554
Equipment	<u>1,084,589</u>	<u>93,921</u>	<u>90,819</u>	<u>1,087,691</u>
Subtotal	<u>18,586,012</u>	<u>1,584,818</u>	<u>244,782</u>	<u>19,926,048</u>
Net capital assets being depreciated	<u>34,239,948</u>	<u>(889,112)</u>	<u>(35,515)</u>	<u>33,315,321</u>
Net capital assets	<u>\$ 38,779,523</u>	<u>\$ (889,112)</u>	<u>\$ (35,515)</u>	<u>\$ 37,854,896</u>

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 4 - Capital Assets (Continued)

	Balance July 1, 2006	Additions	Disposals and Adjustments	Balance June 30, 2007
<b>Business-type Activities</b>				
Capital assets not being depreciated:				
Land	\$ 1,784,331	\$ -	\$ -	\$ 1,784,331
Construction in progress	-	1,008,208	-	1,008,208
Subtotal	1,784,331	1,008,208	-	2,792,539
Capital assets being depreciated:				
Land improvements	45,500	-	-	45,500
Infrastructure	11,203,452	15,415	3,166	11,215,701
Vehicles	526,073	24,311	(2,180)	552,564
Equipment	13,052,637	42,363	51,114	13,043,886
Office equipment	91,863	-	80,018	11,845
Building	9,766,511	14,000	-	9,780,511
Water tower	510,306	-	-	510,306
Special assessment district	549,194	-	-	549,194
Subtotal	35,745,536	96,089	132,118	35,709,507
Accumulated depreciation:				
Land improvements	36,019	2,275	-	38,294
Infrastructure	4,211,463	262,094	305	4,473,252
Vehicles	404,752	37,475	(18,807)	461,034
Equipment	2,526,468	427,189	25,297	2,928,360
Office equipment	91,863	-	80,018	11,845
Building	3,268,291	203,946	-	3,472,237
Water tower	109,671	11,709	-	121,380
Special assessment district	108,010	10,984	-	118,994
Subtotal	10,756,537	955,672	86,813	11,625,396
Net capital assets being depreciated	24,988,999	(859,583)	45,305	24,084,111
Net capital assets	\$ 26,773,330	\$ (859,583)	\$ 45,305	\$ 26,876,650

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 4 - Capital Assets (Continued)

Depreciation expense was charged to programs of the primary government as follows:

Governmental activities:

General government	\$ 6,610
Public safety	3,103
Public works	1,574,505
Recreation and culture	<u>600</u>

Total governmental activities	<u>\$ 1,584,818</u>
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Business-type activities:

Water	\$ 356,583
Sewer	376,483
Electric	<u>222,606</u>

Total business-type activities	<u>\$ 955,672</u>
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Capital asset activity of the City's component units was as follows:

	Balance July 1, 2006	Additions	Disposals and Adjustments	Balance June 30, 2007
<b>Component Units</b>				
Capital assets not being depreciated -				
Land	\$ 586,737	\$ -	\$ -	\$ 586,737
Capital assets being depreciated:				
Land improvements	1,951,530	-	-	1,951,530
Equipment	<u>165,944</u>	<u>-</u>	<u>-</u>	<u>165,944</u>
Subtotal	2,117,474	-	-	2,117,474
Accumulated depreciation:				
Land improvements	298,262	78,061	-	376,323
Equipment	<u>27,653</u>	<u>15,205</u>	<u>-</u>	<u>42,858</u>
Subtotal	<u>325,915</u>	<u>93,266</u>	<u>-</u>	<u>419,181</u>
Net capital assets being depreciated	<u>1,791,559</u>	<u>(93,266)</u>	<u>-</u>	<u>1,698,293</u>
Net capital assets	<u>\$ 2,378,296</u>	<u>\$ (93,266)</u>	<u>\$ -</u>	<u>\$ 2,285,030</u>

**Construction Commitments** - The City has no active construction projects at year end.



# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 5 - Interfund Receivables, Payables, and Transfers

The composition of interfund balances is as follows:

Receivable Fund	Payable Fund	Amount
<b>Due to/from Other Funds</b>		
General Fund	Major Roads Fund	\$ 6,375
	Vehicle and Equipment Fund	807
	Other nonmajor governmental funds	<u>16,467</u>
	Total General Fund	23,649
Proprietary fund - Vehicle and Equipment Fund	Major Roads Fund	1,635
	Other nonmajor governmental funds	<u>5,966</u>
	Total Vehicle and Equipment Fund	<u>7,601</u>
	Total	<u><u>\$ 31,250</u></u>
<b>Due to/from Component Unit</b>		
Downtown Development Authority	General Fund	\$ 10,616
	Other nonmajor governmental funds	<u>22,842</u>
	Total	<u><u>\$ 33,458</u></u>

Interfund balances represent routine and temporary cash flow assistance resulting from normal interfund activity until the amounts can be reimbursed between the funds.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 5 - Interfund Receivables, Payables, and Transfers (Continued)

#### Interfund Transfers

	Transfers Out				Total
	General Fund	Water Fund	Sewer Fund	Other Governmental Funds	
Transfers in:					
General Fund (1)	\$ -	\$ -	\$ 15,000	\$ -	\$ 15,000
Vehicle and Equipment Fund (2)	-	-	17,347	-	17,347
Other governmental funds (1, 3)	<u>45,312</u>	<u>16,128</u>	<u>15,360</u>	<u>90,000</u>	<u>166,800</u>
Total	<u>\$ 45,312</u>	<u>\$ 16,128</u>	<u>\$ 47,707</u>	<u>\$ 90,000</u>	<u>\$ 199,147</u>

(1) Transfer for general operations

(2) Transfer of capital assets

(3) Transfer for capital improvements and debt service on municipal building

### Note 6 - Long-term Debt

The City issues bonds to provide for the acquisition and construction of major capital assets. General obligation bonds are direct obligations and pledge the full faith and credit of the City. Installment purchase agreements are also general obligations of the government. Special assessment bonds provide for capital improvements that benefit specific properties, and will be repaid from amounts levied against those properties benefited from the construction. In the event that a deficiency exists because of unpaid or delinquent special assessments at the time a debt service payment is due, the City is obligated to provide these resources to cover the deficiency until other resources are received.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 6 - Long-term Debt (Continued)

Long-term obligation activity can be summarized as follows:

	Interest Rate	Principal Maturity Ranges	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Governmental Activities</b>							
General obligation bonds:							
2000 Special Assessment:							
Limited Tax G.O. Bonds:							
Amount of issue - \$905,000	4.80%	\$45,000 -					
Maturing through 2021	5.50%	\$50,000	\$ 665,000	\$ -	\$ 50,000	\$ 615,000	\$ 50,000
2002 Limited Tax G.O. Bonds:							
Amount of issue - \$995,000	3.30%	\$35,000 -					
Maturing through 2022	5.15%	\$80,000	880,000	-	35,000	845,000	35,000
Installment purchase agreements:							
Amount of issue - \$79,829	3.99%	\$14,194 -					
Maturing through 2009		\$15,966	50,864	-	15,966	34,898	15,966
Amount of issue - \$87,000	4.50%	\$10,800 -					
Maturing through 2012		\$13,555	72,815	-	10,800	62,015	11,302
Amount of issue - \$152,002	5.07%	\$16,374 -					
Maturing through 2013		\$22,031	133,602	-	16,374	117,228	17,204
Amount of issue - \$63,000	6.50%	\$4,336 -					
Maturing through 2010		\$15,000	52,407	-	14,964	37,443	16,001
Amount of issue - \$48,873	6.05%	\$8,661 -	-	48,873	10,955	37,918	8,661
Maturing through 2011		\$10,955					
Accumulated compensated absences			173,117	-	29,758	143,359	134,000
Landfill postclosure care costs			1,080,000	-	60,000	1,020,000	60,000
Total governmental activities			\$ 3,107,805	\$ 48,873	\$ 243,817	\$ 2,912,861	\$ 348,134

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 6 - Long-term Debt (Continued)

	Interest Rate	Maturity Ranges	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Business-type Activities</b>							
General obligation bonds:							
1993 Unlimited Tax G.O. Bonds:							
Amount of issue - \$1,450,000	4.80%	\$160,000 -					
Maturing through 2008	4.90%	\$170,000	\$ 330,000	\$ -	\$ 160,000	\$ 170,000	\$ 170,000
1993 Limited Tax G.O. Bonds:							
Amount of issue - \$750,000	4.80%	\$70,000 -					
Maturing through 2008	4.90%	\$75,000	145,000	-	75,000	70,000	70,000
1994 Special Assessment Bonds:							
Amount of issue - \$510,000	6.05%	\$20,000 -					
Maturing through 2013	6.45%	\$25,000	150,000	-	25,000	125,000	25,000
Revenue bonds - 1995 Water Supply							
System Revenue Bonds:							
Amount of issue - \$550,000	6.10%	\$30,000 -					
Maturing through 2015	6.50%	\$50,000	350,000	-	30,000	320,000	30,000
2000 Michigan Drinking Water							
Revolving Fund Program,							
\$9,200,000 available to be							
drawn, of which \$8,961,230							
has been drawn down,							
maturing through 2023							
	2.50%	\$395,000 - \$575,000	7,835,000	-	395,000	7,440,000	405,000
Accumulated compensated absences			100,000	5,454	-	105,454	97,000
Total business-type activities			\$ 8,910,000	\$ 5,454	\$ 685,000	\$ 8,230,454	\$ 797,000

Annual debt service requirements to maturity for the above bond and note obligations are as follows:

	Governmental Activities			Business-type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2008	\$ 154,134	\$ 82,813	\$ 236,947	\$ 700,000	\$ 214,307	\$ 914,307
2009	165,129	76,889	242,018	465,000	194,986	659,986
2010	135,447	70,231	205,678	480,000	181,123	661,123
2011	138,239	64,512	202,751	495,000	166,903	661,903
2012	129,523	58,464	187,987	505,000	152,108	657,108
2013-2017	527,030	207,743	734,773	2,565,000	536,941	3,101,941
2018-2022	500,000	72,312	572,312	2,720,000	197,826	2,917,826
2023	-	-	-	195,000	-	195,000
Total	\$ 1,749,502	\$ 632,963	\$ 2,382,465	\$ 8,125,000	\$ 1,644,194	\$ 9,769,194

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 6 - Long-term Debt (Continued)

**Landfill Postclosure Care Costs** - State and federal laws and regulations require the City to perform some remediation to the landfill site and to place a final cover on the landfill, as it no longer has the capacity to accept solid waste. Additionally, the City is required to perform certain maintenance and monitoring functions at the landfill site for 30 years after closure. As of February 28, 1995, all costs of closure have been incurred. Future monitoring costs are estimated by the City to approximate \$60,000 per year and the cost attributable to the remaining 17 years has been recorded as long-term debt. The City currently maintains a letter of credit in the amount of \$380,000 in favor of the Michigan Department of Natural Resources to be used to fund monitoring and remediation costs if they are not completed by the City. The City does not anticipate that the State of Michigan will utilize these funds.

**Component Units** - Long-term obligation activity for the component units can be summarized as follows:

	Interest Rate	Principal Maturity Ranges	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
General obligation bonds - 2000 Downtown Development Limited Tax G.O. Bonds:							
Amount of issue - \$995,000	5.05%-	\$130,000 -					
Maturing through 2010	5.20%	\$150,000	\$ 560,000	\$ -	\$ 130,000	\$ 430,000	\$ 135,000

Annual debt service requirements to maturity for the above component unit bond and note obligations are as follows:

	Principal	Interest	Total
2008	\$ 135,000	\$ 22,153	\$ 157,153
2009	145,000	15,268	160,268
2010	150,000	7,800	157,800
Total	\$ 430,000	\$ 45,221	\$ 475,221

**No Commitment Debt** - Excluded from the City's financial statements are bonds issued by the Economic Development Corporation (the "Corporation"), a component unit of the City of Chelsea, Michigan. The amount of bonds outstanding at December 31, 2006, the most recent audit, totaled \$15,375,000.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 6 - Long-term Debt (Continued)

The Corporation is organized pursuant to State of Michigan Act No. 338 of 1974, as amended. The primary purpose of the Corporation is to encourage and assist commercial and industrial enterprises to locate and expand facilities and services to the City of Chelsea, Michigan and its residents. This purpose is accomplished by the issuance of limited obligation revenue bonds by the Corporation. The Corporation issues limited obligation revenue bonds and, in effect, loans the bond proceeds to commercial and industrial enterprises to finance the cost of projects to be used by such enterprises. The bonds are sometimes, but not always, collateralized by a mortgage on the project or sale/leaseback documentation. In return, the benefited enterprise agrees to pay loan repayments or lease rental in amounts sufficient to pay debt service on the bonds.

The bonds issued by the Corporation are payable solely from the net revenue derived from the respective projects.

### Note 7 - Restricted Assets

The balances of the restricted asset accounts in the business-type activities are as follows:

	Business-type Activities		
	Water	Sewer	Total
Cash and cash equivalents	\$ 220,390	\$ 122,061	\$ 342,451
Assessments receivable	-	80,028	80,028
Property tax receivable	-	7,807	7,807
Total restricted assets	<u>\$ 220,390</u>	<u>\$ 209,896</u>	<u>\$ 430,286</u>

These assets are restricted for debt payments.

### Note 8 - Risk Management

The City is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The City has purchased commercial insurance for medical claims, and participates in the Michigan Municipal League Liability and Property Pool for claims relating to property loss, torts, errors and omissions, workers' compensation, and unemployment compensation. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

### **Note 8 - Risk Management (Continued)**

The Michigan Municipal League Liability and Property Pool program operates as a common risk-sharing management program for local units of government in Michigan; member premiums are used to purchase commercial excess insurance coverage and pay member claims in excess of deductible amounts.

### **Note 9 - Defined Benefit Pension Plan and Postretirement Benefits**

**Plan Description** - The City participates in the Michigan Municipal Employees' Retirement System (MMERS), an agent multiple-employer defined benefit pension plan. The system provides retirement, disability, and death benefits to plan members and their beneficiaries. MMERS issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to MMERS at 1134 Municipal Way, Lansing, MI 48917.

**Funding Policy** - The obligation to contribute to and maintain the system for these employees was established by resolution of the City Council and negotiation with the City's competitive bargaining units.

**Annual Pension Costs** - For the year ended June 30, 2007, the City's annual pension cost of \$345,528 for the plan was less than the required and actual contribution. The City's actual contribution for the year ended June 30, 2007 was \$375,482. The annual required contribution was determined as part of an actuarial valuation at December 31, 2005, using the entry age cost method. Significant actuarial assumptions used include: (a) an 8 percent investment rate of return, (b) projected salary increases of 4.5 percent to 8.66 percent per year, depending on age, attributable to seniority/merit, and (c) the assumption that benefits will increase 2.5 percent per year (annually) after retirement, for certain retirees. Both (a) and (b) include an inflation component of 4.5 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a four-year period. The unfunded actuarial liability is being amortized as a level percent of payroll on a closed basis. The remaining amortization period ranges from 22 to 30 years.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 9 - Defined Benefit Pension Plan and Postretirement Benefits (Continued)

Three-year trend information is as follows:

	Fiscal Year Ended June 30	Fiscal Year Ended June 30	16-month Period Ended June 30
	2007	2006	2005
Annual pension costs (APC)	\$ 345,528	\$ 302,162	\$ 366,868
Percentage of APC contributed	109%	100%	100%
Net pension asset	29,954	-	-
	December 31		
	2006	2005	2004
Actuarial value of assets	\$ 5,339,633	\$ 4,988,510	\$ 4,685,122
Actuarial Accrued Liability (AAL) (entry age)	\$ 8,981,098	\$ 8,077,712	\$ 7,963,857
Unfunded AAL (UAAL)	\$ 3,641,465	\$ 3,089,202	\$ 3,278,735
Funded ratio	59%	62%	59%
Covered payroll	\$ 1,180,479	\$ 1,446,270	\$ 1,464,496
UAAL as a percentage of covered payroll	308%	214%	224%

For the year ended June 30, 2007, the City's net pension asset is as follows:

Annual required contribution	\$ 345,528
Contributions made	<u>(375,482)</u>
Net pension asset	<u>\$ (29,954)</u>



### **Note 9 - Defined Benefit Pension Plan and Postretirement Benefits (Continued)**

#### **Defined Contribution Pension Plan**

The City provides pension benefits to all of its full-time employees hired after September 9, 1997 and full-time employees hired prior to September 9, 1997 who elect to convert to this plan from the defined benefit pension plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. As established by resolution of the City Council and negotiation with the City's competitive bargaining units, the City contributes 7 percent of employees' gross earnings. Employees may contribute to the plan additional amounts on an after-tax basis. In accordance with these requirements, the City contributed \$93,023 and employees contributed \$15,000 during the current year.

**Postemployment Benefits** - The City provides healthcare benefits to all full-time employees upon retirement, in accordance with labor contracts and City Council resolution. Currently, nine retirees are eligible. The City includes pre-Medicare retirees and their dependents in its insured healthcare plan, with a contribution required by the participant. Expenditures for postemployment healthcare benefits are recognized as the insurance premiums become due; during the year, this amounted to approximately \$77,000.

The Governmental Accounting Standards Board has recently released Statement No. 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The new rule will cause the government-wide financial statements to recognize the cost of providing retiree healthcare coverage over the working life of the employee, rather than at the time the healthcare premiums are paid. The new pronouncement is effective for the year ending June 30, 2009.

# City of Chelsea, Michigan

## Notes to Financial Statements June 30, 2007

### Note 10 - Joint Ventures

The City is a member of the Chelsea Area Fire Authority (the "Fire Authority"), which provides services to the residents of the City of Chelsea, the Township of Lima, the Township of Lyndon, the Township of Sylvan, and the Township of Waterloo. The Fire Authority began operations in June 1999 and the participating communities provide annual funding for its operations. During the current year, the City contributed approximately \$332,000 for its operations. The City is unaware of any circumstances that would cause an additional benefit or burden to the participating governments in the near future. Complete financial statements for the Chelsea Area Fire Authority can be obtained from the administrative offices at 200 West Middle, Chelsea, Michigan 48118.

The City is also a member of the Chelsea Area Construction Agency (the "Agency"), which provides building, electrical, mechanical, and plumbing permits, along with other related services, to the residents of the City of Chelsea, the Township of Dexter, the Township of Lima, the Township of Lyndon, the Township of Sylvan, and the Township of Sharon. The Agency began operations in March 2000 and is a self-funded operation. The City is unaware of any circumstances that would cause an additional benefit or burden to the participating governments in the near future. Complete financial statements for the Chelsea Area Construction Agency can be obtained from the administrative offices at 18027 Old U.S. 12, Suite 100, Chelsea, Michigan 48118.

The investments in joint ventures are recorded in the statement of net assets as follows:

Chelsea Area Fire Authority	\$ 297,296
Chelsea Area Construction Agency	<u>162,347</u>
Total	<u>\$ 459,643</u>

### Note 11 - Contingencies

During 1998, the City was contacted by the Michigan Department of Environmental Quality regarding possible groundwater contamination as a result of a closed municipal landfill. Financial responsibility, if any, for resulting damages will be shared with surrounding townships. The likelihood of loss cannot yet be determined; however, based on investigation by the City's consultants, contamination of the groundwater was not apparent.

## **Required Supplemental Information**

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# City of Chelsea, Michigan

## Required Supplemental Information Budgetary Comparison Schedule - General Fund Year Ended June 30, 2007

	Original Budget	Amended Budget	Actual	Variance with Amended Budget
<b>Revenue</b>				
Property taxes:				
Real and personal property taxes	\$ 2,475,876	\$ 2,475,876	\$ 2,535,389	\$ 59,513
Payments in lieu of taxes	331,500	331,500	322,724	(8,776)
Total property taxes	2,807,376	2,807,376	2,858,113	50,737
Federal sources	-	-	3,327	3,327
State sources:				
Revenue sharing	375,000	375,000	424,633	49,633
Liquor license fees	5,000	5,000	4,781	(219)
Total state sources	380,000	380,000	429,414	49,414
Licenses and permits:				
Building permits	55,000	55,000	43,939	(11,061)
Zoning changes	135,000	143,000	147,708	4,708
Total licenses and permits	190,000	198,000	191,647	(6,353)
Charges for services:				
Recycling	2,000	9,500	9,643	143
Other	5,000	-	-	-
Total charges for services	7,000	9,500	9,643	143
Fines and forfeitures	10,000	14,000	15,557	1,557
Interest	20,000	39,000	46,970	7,970
Other revenue:				
Reimbursement	80,000	80,000	124,446	44,446
Other	47,515	74,515	95,528	21,013
Total other revenue	127,515	154,515	219,974	65,459
Transfers in	15,000	15,000	15,000	-
Total revenue	3,556,891	3,617,391	3,789,645	172,254

# City of Chelsea, Michigan

## Required Supplemental Information Budgetary Comparison Schedule - General Fund (Continued) Year Ended June 30, 2007

	Original Budget	Amended Budget	Actual	Variance with Amended Budget
<b>Expenditures</b>				
General government:				
Village Council	\$ 19,000	\$ 17,500	\$ 16,676	\$ 824
Executive	173,000	233,000	245,325	(12,325)
Elections	16,800	19,300	16,004	3,296
General and administrative	726,300	672,300	638,343	33,957
Other	93,812	88,812	89,854	(1,042)
Total general government	1,028,912	1,030,912	1,006,202	24,710
Public safety:				
Police	1,052,500	1,050,700	1,124,283	(73,583)
Civil defense	17,360	17,360	16,586	774
Total public safety	1,069,860	1,068,060	1,140,869	(72,809)
Public works:				
Department of Public Works	612,300	574,300	531,429	42,871
Recycling	25,000	25,000	28,590	(3,590)
Total public works	637,300	599,300	560,019	39,281
Parks and recreation	51,500	47,500	55,595	(8,095)
Planning and zoning	209,500	207,300	199,162	8,138
Employee benefits and insurance	716,500	723,000	759,759	(36,759)
Total expenditures	3,713,572	3,676,072	3,721,606	(45,534)
<b>Excess of Revenue Over (Under) Expenditures</b>	(156,681)	(58,681)	68,039	126,720
<b>Fund Balance - Beginning of year</b>	253,423	253,423	253,423	-
<b>Fund Balance - End of year</b>	<u>\$ 96,742</u>	<u>\$ 194,742</u>	<u>\$ 321,462</u>	<u>\$ 126,720</u>

# City of Chelsea, Michigan

## Required Supplemental Information Budgetary Comparison Schedule - Special Revenue Fund Major Roads Fund Year Ended June 30, 2007

	Original Budget	Amended Budget	Actual	Variance with Amended Budget
<b>Revenues</b>				
State sources	\$ 225,000	\$ 186,000	\$ 229,397	\$ 43,397
Interest and other	18,000	24,000	40,021	16,021
Total revenues	243,000	210,000	269,418	59,418
<b>Expenditures</b>				
Construction	564,000	293,500	300,752	(7,252)
Routine maintenance	67,000	53,000	63,332	(10,332)
Traffic services	8,200	4,600	6,363	(1,763)
Winter maintenance	16,600	18,100	16,410	1,690
Professional services	1,200	1,200	1,450	(250)
Surface maintenance	1,000	1,000	29	971
Sweeping and flushing	3,210	3,210	3,198	12
Trees and shrubs	300	300	424	(124)
Drainage and backsloping	2,200	1,200	133	1,067
Traffic signs and signals	2,760	4,660	5,492	(832)
Winter	10,790	5,790	4,289	1,501
Miscellaneous	4,740	4,740	4,367	373
Total expenditures	682,000	391,300	406,239	(14,939)
<b>Excess of Expenditures Over Revenue</b>	(439,000)	(181,300)	(136,821)	44,479
<b>Fund Balance - Beginning of year</b>	818,176	818,176	818,176	-
<b>Fund Balance - End of year</b>	<u>\$ 379,176</u>	<u>\$ 636,876</u>	<u>\$ 681,355</u>	<u>\$ 44,479</u>

# City of Chelsea, Michigan

## Note to Required Supplemental Information June 30, 2007

**Budgetary Information** - The annual budgets are prepared by the city manager and adopted by the City Council; subsequent amendments are approved by the City Council. Unexpended appropriations lapse at year end; encumbrances are not included as expenditures. The amount of encumbrances outstanding at June 30, 2007 is not known. During the current year, the budget was amended in a legally permissible manner.

The budgets have been prepared in accordance with accounting principles generally accepted in the United States of America for the General Fund and all Special Revenue Funds, with the exception that operating transfers have been included in the "revenue" and/or "expenditures" categories, rather than as "other financing sources (uses)."

The budgets have been adopted on an activity basis; expenditures at this level in excess of amounts budgeted are a violation of Michigan law. Comparison of actual results of operations to the budgets of the General Fund and Major Roads Fund, as adopted by the City Council, are included in the required supplemental information of the basic financial statements. A comparison of the actual results of operations to the nonmajor Special Revenue Funds budgets, as adopted by the City, is available at the City offices for inspection.

**Excess of Expenditures Over Budgeted Amounts** - The City had the following significant expenditure budget overruns:

	Amended Budget	Actual	Variance
General Fund:			
Public safety - Police (1)	\$ 1,050,700	\$ 1,124,283	\$ (73,583)
Employee benefits and insurance (2)	723,000	759,759	(36,759)

(1) Variance resulting from additional expenditures relating to salaries

(2) Variance resulting from additional expenditures relating to retirement

**Deficits** - The Internal Service Fund had an accumulated fund deficit for unrestricted net assets of \$9,352 at June 30, 2007.

## **Other Supplemental Information**

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# City of Chelsea, Michigan

	Special Revenue			
	Local Roads	Municipal Road Fund	Emergency 911	Drug Law Enforcement
<b>Assets</b>				
Cash and investments	\$ 80,218	\$ 986,939	\$ 96,646	\$ 44,283
Receivables:				
Taxes	-	8,345	-	-
Customers	-	-	-	-
Due from other governmental units	10,371	-	-	-
Total assets	<u>\$ 90,589</u>	<u>\$ 995,284</u>	<u>\$ 96,646</u>	<u>\$ 44,283</u>
<b>Liabilities and Fund Balances</b>				
<b>Liabilities</b>				
Accounts payable	\$ 29,387	\$ -	\$ -	\$ -
Accrued and other liabilities	-	-	-	-
Due to other funds	22,433	-	-	-
Due to component units	-	17,754	-	-
Total liabilities	51820	17754	-	-
<b>Fund Balances</b>				
Reserved:				
Law enforcement	-	-	96,646	44,283
Solid waste activities	-	-	-	-
Storm water utility	-	-	-	-
Unreserved and undesignated	38,769	977,530	-	-
Total fund balances	38,769	977,530	96,646	44,283
Total liabilities and fund balances	<u>\$ 90,589</u>	<u>\$ 995,284</u>	<u>\$ 96,646</u>	<u>\$ 44,283</u>

**Other Supplemental Information  
Combining Balance Sheet  
Nonmajor Governmental Funds  
June 30, 2007**

Funds		Capital Project Fund		Total Nonmajor Governmental Funds
Solid Waste Facility	Storm Water Utility	Municipal Building		
\$ 304,916	\$ 93,455	\$ 268,644		\$ 1,875,101
2,391	-	-		10,736
9,500	41,937	-		51,437
-	-	-		10,371
<u>\$ 316,807</u>	<u>\$ 135,392</u>	<u>\$ 268,644</u>		<u>\$ 1,947,645</u>
\$ 18,426	\$ 153	\$ -		\$ 47,966
22,854	831	-		23,685
-	-	-		22,433
5,088	-	-		22,842
46368	984	-		116926
-	-	-		140,929
270,439	-	-		270,439
-	134,408	-		134,408
-	-	268,644		1,284,943
270,439	134,408	268,644		1,830,719
<u>\$ 316,807</u>	<u>\$ 135,392</u>	<u>\$ 268,644</u>		<u>\$ 1,947,645</u>

# City of Chelsea, Michigan

	Special Revenue			
	Local Roads	Municipal Road Fund	Emergency 911	Drug Law Enforcement
<b>Revenue</b>				
Property taxes	\$ -	\$ 344,937	\$ -	\$ -
State sources	63,157	-	-	416
Local sources	-	-	62,778	-
Charges for services	-	-	-	-
Interest and other	3,210	38,923	2,948	2,600
Total revenue	66,367	383,860	65,726	3,016
<b>Expenditures</b>				
General government	1,485	-	-	611
Public works:				
Street construction	35,837	-	-	-
Street routine maintenance	174,990	-	-	-
Traffic services	4,849	-	-	-
Winter maintenance	25,830	-	-	-
Operation and maintenance	-	-	116,796	-
Total public works	241,506	-	116,796	-
Debt service	-	-	-	-
Total expenditures	242,991	-	116,796	611
<b>Excess of Revenue Over (Under) Expenditures</b>	(176,624)	383,860	(51,070)	2,405
<b>Other Financing Sources (Uses)</b>				
Transfers in	90,000	-	-	-
Transfers out	-	(90,000)	-	-
Total other financing sources (uses)	90,000	(90,000)	-	-
<b>Net Change in Fund Balances</b>	(86,624)	293,860	(51,070)	2,405
<b>Fund Balances - Beginning of year</b>	125,393	683,670	147,716	41,878
<b>Fund Balances - End of year</b>	<u>\$ 38,769</u>	<u>\$ 977,530</u>	<u>\$ 96,646</u>	<u>\$ 44,283</u>

**Other Supplemental Information**  
**Combining Statement of Revenue, Expenditures, and Changes**  
**in Fund Balances - Nonmajor Governmental Funds**  
**Year Ended June 30, 2007**

Funds		Capital Project Fund	
Solid Waste Facility	Storm Water Utility	Municipal Building	Total Nonmajor Governmental Funds
\$ 98,837	\$ -	\$ -	\$ 443,774
-	-	-	63,573
-	-	-	62,778
358,443	104,935	-	463,378
16,196	206	1,293	65,376
473,476	105,141	1,293	1,098,879
251,030	-	-	253,126
-	-	-	35,837
-	-	-	174,990
-	-	-	4,849
-	-	-	25,830
147,819	53,529	-	318,144
147,819	53,529	-	559,650
17,959	-	76,550	94,509
416,808	53,529	76,550	907,285
56,668	51,612	(75,257)	191,594
-	-	76,800	166,800
-	-	-	(90,000)
-	-	76,800	76,800
56,668	51,612	1,543	268,394
213,771	82,796	267,101	1,562,325
<b>\$ 270,439</b>	<b>\$ 134,408</b>	<b>\$ 268,644</b>	<b>\$ 1,830,719</b>



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October 22, 2007

To the Mayor and Members  
of City Council  
City of Chelsea  
305 S. Main Street, Suite 100  
Chelsea, MI 48118

Dear Mayor and Council Members:

New auditing rules effective December 31, 2006 have resulted in some changes in the communications that we are required to provide following our audit. These rules require us to more formally communicate matters we note about your accounting procedures and internal controls. While we have always provided our observations in these areas as part of our audit, we are now required to tell you about more items than we may have in the past and to communicate them in writing.

The new auditing standards (Statement on Auditing Standards Number 112, referred to as SAS 112) require us to inform you about any matters noted in your accounting procedures or internal controls that the new auditing standards define as a significant deficiency. The new threshold for a significant deficiency is a low one - a significant deficiency is any flaw that creates more than a remote risk of errors in your financial statements that could matter to a user of the statements. Matters that may be immaterial to the financial statements still may be classified by the new auditing standards as a significant deficiency. For example, the requirements of SAS 112 go so far as to classify certain journal entries proposed by your auditor as a significant deficiency.

We are also required to communicate these matters to more people. In the past, we have provided our comments and observations as part of a meeting or discussion at the end of our work directly to management. Under these new rules, we are obligated to communicate these matters in writing to all individuals involved in overseeing strategic direction and accountability for your operations, including the board of trustees, in addition to our communications with management. This communication is intended to comply with the requirements of the new auditing standards.

In planning and performing our audit of the financial statements of the City of Chelsea as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.



Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

We consider the following significant deficiencies, in the aggregate, to be material weaknesses:

- **Audit Journal Entries** - As a result of the auditing procedures performed, we detected and proposed the following significant audit adjustments. In all instances, the City posted the proposed journal entries to more accurately reflect the financial condition of the City at June 30, 2007.
  - **Accounts Payable** - As a result of a review of checks written after June 30, 2007, we noted goods/services that were incurred prior to year end but were improperly excluded from expenditures and accounts payable at June 30, 2007. This was corrected through an audit adjustment.
  - **Special Assessment Receivables and Deferred Revenue** - As payments on special assessments are received throughout the year, the City records revenue for the amount collected but does not adjust the related accounts receivable and deferred revenue balances throughout the year. An audit adjustment was made to adjust the special assessment receivable and deferred revenue accounts to reflect payments received during the year.

- **Capital Assets** - An audit adjustment was made to record an asset in the Sewer Fund related to state grant funds that were used to fund a site plan for the waste water treatment plant. These amounts had been expensed. There was also an adjustment made to record current year depreciation expense for the Downtown Development Authority.
- **Accrued Interest** - As a result of a review of accrued interest, we noted that when the entry was made to record the current year amount, the entire amount was accrued and expensed when there was already a liability recorded, therefore resulting in an overstatement of the accrual. An audit adjustment was made to adjust the amount.

We also noted other accounting and legislative matters that we would like to communicate to you. In an effort to assist with the City's efforts toward improved operational and financial health, we offer the following observations:

### **Revenue Sharing**

The future of the State's revenue-sharing program continues to be directly tied to the condition of the State's budget. Reductions to statutory revenue sharing started in 2001 as shortfalls began occurring in the State's budget. The State's budget shortfalls continue to be significant. As a result of the marathon budget negotiations recently held to avoid a state shutdown, there were tax increases, a few "government reforms," and a continuation budget which keeps state government in business for 30 days while the legislature finalizes the 2007/2008 budget. The tax increases are projected to close approximately \$1.45 billion of the \$1.8 billion budget gap. The most significant reform relates to MESSA, which is the public school health care program.

At this point, no further cuts have been made to revenue sharing. The unwritten agreement is that revenue sharing will be funded at fiscal year 2006/2007 levels but this is still to be finalized. The outcome of other matters will also impact revenue sharing and those matters include:

- **Future of County Participation in Statutory Revenue Sharing** - In 2004, the State terminated payment of statutory revenue sharing to counties (which was approximately \$182 million) but allowed counties to move their operating tax levy to July from December. Counties are required to deposit the additional monies from the earlier levy into a "reserve fund" which is to be used by the counties to replace lost statutory revenue sharing in future years. The question that remains is when the reserve funds established by counties are depleted, will counties come back into the "revenue-sharing formula" and to what extent? Will the size of the statutory pot grow to accommodate counties or will there be a shift of the same monies from cities, villages, and townships to the counties?
- **Statutory Revenue-sharing Formula Expires in 2007** - Legislative action is required on this Act for appropriations to continue into 2008 and beyond.

- **Changes to Michigan's Tax Structure** - The Michigan single business tax has been eliminated effective December 31, 2007, which will result in the loss of \$1.9 billion from the State's budget in 2008. In June 2007, a replacement for the single business tax - called the new Michigan business tax - was approved by the legislature. In the overview, the plan creates a new tax structure for Michigan businesses, provides further personal property tax relief to business taxpayers, and is forecasted by the State to generate about the same revenue (\$1.9 billion) as the single business tax. Technical corrections on this recently passed law are still pending and the law is lengthy and complex. The true financial impact on the State's budget is hard to predict.

While the debate is in process there still remain considerably more questions than answers regarding long-term funding of statutory revenue sharing. Decisions still remain on the ultimate funding level for revenue sharing for the State's fiscal years 2006/2007 and 2007/2008. Local governments may need to react with budget amendments when these final decisions are made by the State.

If the State were to eliminate the statutory portion of revenue sharing (as the constitutional portion cannot be modified without a change to the State's constitution), the City has \$118,000 at risk in its General Fund budget based on 2008 estimated funding levels. In light of the current environment, we strongly encourage local governments to be conservative when budgeting or projecting the revenue-sharing line item.

### **New Michigan Business Tax**

As previously indicated, the new Michigan business tax (MBT) was approved by the legislature in June 2007 and replaces the single business tax (SBT) which expires December 31, 2007. According to the State, the new MBT is intended to generate about the same \$1.9 billion generated by the expiring SBT

While the MBT intended to simplify the old SBT, the MBT is a very lengthy and complicated new law. The new MBT imposes two taxes - a modified gross receipts tax and a business income tax. The modified gross receipts tax is imposed at .8 percent on a tax base composed of gross receipts less certain purchases. The business income tax will be imposed at a rate of less than 5 percent on business income. The MBT provides for new investment, compensation, and research and development credits to businesses. The MBT also allows certain qualified small businesses to opt out of the MBT and pay a straight 1.8 percent tax on adjusted business income.



More personal property tax relief is also part of the new MBT. Business personal property classified as “industrial” or “commercial” will be exempt from certain personal property taxes - specifically from the State Education Tax (SET) and local school operating mills. “Industrial” personal property will receive exemptions from the 6 SET mills and the 18 schools operating mills (for a total 24 mill exemption). “Commercial” personal property will be exempt from 12 of the 18 school operating mills.

These newly enacted personal property tax exemptions will mean that local governments will collect less school taxes on these properties. For local governments that have enacted an administrative fee on tax collections, they will likely see a decrease in the administration fees that have traditionally been collected. Also, for those local governments with tax increment financing authorities that continue to have existing eligible obligations outstanding and are therefore allowed to capture school taxes (to the extent of these eligible obligations), the personal property tax exemptions on school millages will likely decrease the amount of school taxes available to capture.

Given the favorable tax treatment of industrial versus commercial personal property, it is expected that businesses will be re-reviewing the classification of their personal property. Your assessor will likely receive more frequent inquiries and requests to change classification of personal property to take the most advantage of the tax break afforded to industrial property and commercial property and the additional relief available for industrial property.

As we understand it now, these are the areas at the local governmental level (i.e., impact on administrative fees, impact on school dollars available for capture for certain tax increment financing authorities, and property classifications) that are the most directly impacted by the new MBT.

We will keep you updated as we continue to explore these and other issues regarding the impact of the MBT on local units of government.

### **New Audit Standards**

The following new audit standards, issued by the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board, have been implemented for the City's June 30, 2007 year end:

- **Statement on Auditing Standards No. 103 (Audit Documentation)** - This standard clarifies and increases the requirements that auditors must follow in obtaining, managing, and retaining documentation that supports the audit opinion. It prescribes the form, content, and extent of audit documentation necessary to support the audit work. It also redefines the method used to determine the dating of the auditor's report and creates a "lock down" date for the audit file.

The impact of this new standard resulted in increased requests for audit documentation and dating the opinion letter later than in previous years.

- **Statement on Auditing Standards No. 112 - Communicating Internal Control Related Matters Identified in an Audit** - This standard establishes standards and provides guidance regarding the auditor's communication responsibility to those charged with governance (i.e., council or finance/audit committee) concerning significant deficiencies and material weaknesses in internal control noted in a financial statement audit. The standard defines internal control deficiency, significant deficiency (this term replaces the term "reportable condition"), and material weakness. Internal control deficiencies that constitute significant deficiencies and material weaknesses will be reported, in writing, to those charged with governance and will be made no later than 60 days following the release date of the auditor's report on the financial statements.

The impact of this new standard resulted in more significant deficiencies being reported due to the lower threshold for reporting internal control deficiencies. For example, items such as audit adjustments and passed adjustments are now considered strong indicators of internal control deficiencies.

In addition to the two new Auditing Standards listed above, eight Auditing Standards will be effective for the City's June 30, 2008 year end. Statements on Auditing Standards No. 104 to 111 (the Risk Assessment Standards) will substantially impact and change the future audit process. We are currently evaluating the specific impact and changes of these standards on our audit process. We will keep you apprised of our progress.

### **Municipal Finance Act Revisions**

The Municipal Finance Act was amended several years ago. Communities are now required to submit a filing once a year with the Michigan Department of Treasury. The old 10-day “exemption from prior approval” process has been eliminated and is replaced with this qualification process. This filing will serve as a pre-approval for future debt issues. The current filing is due within six months following the end of the City’s year ended June 30, 2007 and is good for one year thereafter. The City should consider the need to file a qualifying statement for each of its component units.

### **Funding of Postemployment Benefit Obligations**

As mentioned in previous years, the Governmental Accounting Standards Board has released Statement Number 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The pronouncement provides guidance for local units of government in recognizing the cost of retiree healthcare benefits. The intent of the new rules is to recognize the cost of providing retiree healthcare coverage over the working life of the employee, rather than at the time the healthcare premiums are paid. These new rules will apply to the government-wide financial statements, rather than the individual fund level. As a result, the City will need to continue to budget for contributions to a pre-funding plan. For many communities, the funding of postemployment benefits is the most significant financial challenge they will face in coming years. The statement, as previously mentioned, will be effective for the City’s fiscal year ending June 30, 2009. The City will need to perform an actuarial valuation during the fiscal year ending June 30, 2008 to provide an estimate as to what these annual costs may amount to. The cost of health care currently paid each year as premiums become due has been increasing and the trend is expected to continue.

To the Mayor and Members  
of City Council  
City of Chelsea

8

October 22, 2007

We would like to thank the entire City staff for their assistance during the audit. We appreciate the opportunity to serve as your auditors. If there are any questions about your financial report or the above comments and recommendations, we would be happy to discuss them at your convenience.

Very truly yours,

**Plante & Moran, PLLC**

A handwritten signature in black ink, appearing to read "David H. Helisek". The signature is fluid and cursive.

David H. Helisek

A handwritten signature in black ink, appearing to read "Monika M. Lesinski". The signature is in a cursive style.

Monika M. Lesinski